

This letter discusses the tax treatment of automobiles used in a "rent to own" business. See 35 ILCS 120/1 et seq. (This is a GIL).

March 28, 2002

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Dear Xxxxx:

This letter is in response to your letter dated January 7, 2002. Arnold Wells has forwarded your letter to the Legal Services Office for reply. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We are a licensed used auto dealership and also carry rental vehicles. We now want to add Rent to Own automobiles to our business. Please send tax requirements for us to add Rent to Own to our business. Enclosed is a a rental agreement as a Rent to Own associate. Their address is:

Name/address

Most contracts would be for more than one year. Renters may return vehicles at any time. Renters are required to carry liability insurance.

Thank you.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax on Illinois retailers measured by a percentage of their gross receipts from sales for use or consumption. 35 ILCS 120/1 et seq. The Use Tax Act imposes a corresponding tax on purchasers by taxing the use of tangible personal property purchased from retailers. 35 ILCS 105/1 et seq.

In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See the enclosed copies of 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts and the lessees incur no Use Tax liability for the rental charges. In Illinois, a true lease generally has no buy out provision at the close of the lease. If

a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

As stated above, lessees do not incur Use Tax liability in true lease situations. However, when a lessee registers the automobile, the lessee must either show that tax has been paid or that there exists an exemption from tax. If a lessee does not have documentation that the lessor has properly paid Illinois tax, the tax, as a practical matter, has to be paid by the lessee in order to register the vehicle since there is no exemption for leased vehicles.

While lessees do not incur any tax liability in a true lease situation, it is typical of true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to satisfy that duty because of a contractual agreement, not because of Illinois tax law. Again, lessors are liable for Use Tax when they purchase vehicles for leasing purposes. However, lessors may have contractually required lessees to reimburse the lessors for the lessors' Use Tax that is incurred by the lessors in regard to the purchase of the leased vehicles.

The alternative to a true lease is a conditional sale. In Illinois, a conditional sale is usually characterized by a nominal purchase option at the close of the lease term. This type of transaction is considered a conditional sale at the outset of the transaction making all receipts subject to Retailers' Occupation Tax. See Section 130.2010. In this situation, lessors/retailers may give Certificates of Resale to their suppliers for tangible personal property transferred subject to a conditional sales agreement. The lessors/retailers owe Retailers' Occupation Tax on any installment payments when they are received by the lessors/retailers. The lessees/purchasers owe corresponding Use Tax on the amount of the installment payments that are collected by the lessors/retailers. Please note, tax on motor vehicles has to be paid up front at one time.

It appears that the transactions you intend to enter into are conditional sales. However, the following information regarding the rental of automobiles may be useful. Receipts from the rental of automobiles in Illinois for lease terms of one year or less are subject to Automobile Renting Occupation and Use Tax. See 35 ILCS 155/1 et seq. Persons engaged in Illinois in the short-term automobile leasing business are taxed at the rate of 5% of the gross rental receipts. See 86 Ill. Adm. Code 180.101(a). A corresponding Automobile Renting use Tax is imposed upon the privilege of using in Illinois an automobile rented from an automobile rentor under a lease term of one year or less. See 86 Ill. Adm. Code 190.101(a). Under 35 ILCS 120/2-5(5), the gross receipts from the sale of automobiles that are used for automobile renting as defined in the Automobile Renting Occupation and use Tax Act are exempt from sales tax. However, under Section 1c of the Retailers' Occupation Tax Act, a person who is engaged in the business of leasing or renting motor vehicles to others and who, in connection with such business sells any used motor vehicle to a purchaser for his use and not for the purpose of resale is a retailer engaged in the business of selling tangible personal property at retail to the extent of the value of the vehicle sold. Such retailers must pay Retailers' Occupation Tax when selling vehicles coming off lease.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.